

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND

FINANCIAL STATEMENTS

JUNE 30, 2005

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
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## Independent Auditors' Report

To the Management  
Delaware Water Pollution Control  
Revolving Loan Fund  
State of Delaware

We have audited the accompanying financial statements of Delaware Water Pollution Control Revolving Loan Fund (the Fund) of the State of Delaware, as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of Delaware Water Pollution Control Revolving Loan Fund, as of June 30, 2005 and 2004, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the Fund and are not intended to present fairly the financial position of the State of Delaware, and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

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## Independent Auditors' Report (Cont'd.)

In accordance with Government Auditing Standards, we have also issued our report dated September 14, 2005, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*McBride, Shopa & Co*

Wilmington, Delaware  
September 14, 2005

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2005

(\$000's omitted)

As management of the Delaware Water Pollution Control Revolving Fund ("Fund"), we offer readers of the Fund's financial statements this narrative overview and analysis of the financial activities of the Fund for the fiscal year ended June 30, 2005. All amounts unless otherwise indicated are expressed in thousands of dollars.

This section of the Fund's annual financial report presents management's discussion and analysis of the financial performance during the fiscal year. Please read it in conjunction with the Fund's financial statements, which follow this section.

Overview of the Financial Statements

This discussion and analysis is an introduction to the Fund's basic financial statements. The Fund's basic financial statements are comprised of two components: fund financial statements and notes to the financial statements.

Financial Highlights

In FY 2005 the Delaware Department of Natural Resources and Environmental Control ("DNREC") was awarded its twelfth capitalization grant from the U.S. Environmental Protection Agency ("EPA"). As of June 30, 2005 DNREC has received capitalization grants in an aggregate amount of \$107,189 since the inception of the Fund. As of June 30, 2005, the State of Delaware has provided state match funds of \$21,438 since the inception of the Fund. The combined total capitalization amount has been \$128,627 since the inception of the Fund.

The Fund realized operating income of \$1,085 in fiscal year 2005, which represents an increase of 5% from fiscal year 2004. Grants received from Federal and State governments totaled \$8,285 in fiscal year 2005, a 50% decrease from fiscal year 2004. Decrease in grants received was due to the decrease in loan disbursements, which are reimbursed by grants.

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2005

(\$000's omitted)

Financial Highlights (continued)

Operating revenues (including interest income on loans) increased \$169 or 11% from the previous year.

Loans made totaled \$8,863 during the fiscal year, which represents a decrease of \$8,167 or 48% from the previous fiscal year. Decrease in loan disbursements is primarily a result of several large municipal loans being disbursed during fiscal year 2004 and not repeated in fiscal year 2005.

Loan originations (commitments) totaled \$8,442 as of June 30, 2005, which represents an increase of \$8,910 from the previous year, or 51%.

Loan collections (principal) totaled \$3,704 during the fiscal year. This represents an increase of \$97 or 3% from the previous year. Principal loan collections will continue to grow as the number of loans outstanding increases.

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2005

(\$000's omitted)

Statement of Net Assets

The following condensed statement of net assets (thousands of dollars) shows a summary of changes in dollars and percentages between fiscal years:

	2005	2004	Increase/ Decrease Amount	Increase/ Decrease %
<b>ASSETS</b>				
<b>CURRENT ASSETS</b>				
Cash	\$ 39,492	\$ 34,745	\$ 4,747	14%
Grants receivable	39	34	5	15%
Administrative fees receivable	837	651	186	29%
Interest receivable	103	107	(4)	(4)%
Loans receivable - current	3,396	3,388	8	-
Other receivables	-	-	-	-
	<u>43,867</u>	<u>38,925</u>	<u>4,942</u>	<u>13%</u>
<b>NONCURRENT ASSETS</b>				
Loans receivable - less current portion	<u>77,617</u>	<u>72,453</u>	<u>5,164</u>	<u>7%</u>
<b>TOTAL ASSETS</b>	<u><u>\$121,484</u></u>	<u><u>\$111,378</u></u>	<u><u>\$ 10,106</u></u>	<u><u>9%</u></u>
 <b>LIABILITIES AND RETAINED EARNINGS</b>				
<b>CURRENT LIABILITIES</b>				
Vouchers payable	\$ 86	\$ 36	\$ 50	139%
Accrued expenses	-	-	-	-
	<u>86</u>	<u>36</u>	<u>50</u>	<u>139%</u>
<b>TOTAL LIABILITIES</b>	<u>86</u>	<u>36</u>	<u>50</u>	<u>139%</u>
 <b>NET ASSETS</b>	<u>121,398</u>	<u>111,342</u>	<u>10,056</u>	<u>9%</u>
 <b>TOTAL LIABILITIES &amp; NET ASSETS</b>	<u><u>\$121,484</u></u>	<u><u>\$111,378</u></u>	<u><u>\$ 10,106</u></u>	<u><u>9%</u></u>

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2005

(\$000's omitted)

Statement of Net Assets (continued)

The combined total net assets of the Fund for the year ending June 30, 2005 increased by 9%.

Cash increased \$4,747 or 14% to \$39,492 as funds were received from federal and state contributions, and loan collections were greater than funds used for loan disbursements.

Total liabilities' increase of \$50 was due to the increase in vouchers payable at the end of the fiscal year. Vouchers payables represent the amount of disbursements/payments which were requested/earned in fiscal year 2005 but not paid until the following fiscal year. The increase is due to timing and does not reflect any long term trend.

Statement of Revenue, Expenses and Changes in Fund Net Assets

The following schedule summarizes the statement of revenue, expenses and changes in net assets (thousands of dollars) of the Fund for the fiscal years ended June 30, 2005 and 2004:

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2005

(\$000's omitted)

	2005	2004	Increase/ (Decrease) Amount	Increase/ (Decrease) %
<b>OPERATING REVENUES</b>				
Interest income on loans	\$ 649	\$ 573	\$ 76	13%
Administrative fee revenue	1,072	977	95	10%
Application fees	3	3	-	-
Other income	1	3	(2)	-
	<u>1,725</u>	<u>1,556</u>	<u>169</u>	<u>11%</u>
<b>OPERATING EXPENSES</b>				
Reimbursable expenditures under operating grants				
Personnel costs	463	417	46	11%
Travel	3	3	-	-
Contractual services	161	56	105	188%
Supplies	11	21	(10)	(48)%
Other expenses	2	23	(21)	(91)%
Loans made	<u>8,863</u>	<u>17,030</u>	<u>(8,167)</u>	<u>(48)%</u>
	<u>9,503</u>	<u>17,550</u>	<u>(8,047)</u>	<u>(46)%</u>
Adjustments to reconcile reimbursable expenditures to operating expenses				
Less: Loans made	<u>(8,863)</u>	<u>(17,030)</u>	<u>8,167</u>	<u>48%</u>
<b>TOTAL OPERATING EXPENSES</b>	<u>640</u>	<u>520</u>	<u>120</u>	<u>23%</u>
<b>OPERATING INCOME</b>	<u>1,085</u>	<u>1,036</u>	<u>49</u>	<u>5%</u>
<b>NONOPERATING REVENUE</b>				
Interest income on deposits	686	438	248	57%
Contributions - EPA	6,904	13,707	(6,803)	(50)%
Contributions - State of Delaware	<u>1,381</u>	<u>2,741</u>	<u>(1,360)</u>	<u>(50)%</u>
	<u>8,971</u>	<u>16,886</u>	<u>(7,915)</u>	<u>(47)%</u>
<b>CHANGE IN NET ASSETS</b>	<u>10,056</u>	<u>17,922</u>	<u>\$ (7,866)</u>	<u>(44)%</u>
<b>BEGINNING NET ASSETS</b>	<u>111,342</u>	<u>93,420</u>		
<b>ENDING NET ASSETS</b>	<u>\$121,398</u>	<u>\$111,342</u>		

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENTAL CONTROL  
DELAWARE WATER POLLUTION CONTROL REVOLVING LOAN FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Cont'd.)  
JUNE 30, 2005

(\$000's omitted)

Statement of Revenue, Expenses and Changes in Fund Net Assets (continued)

The Fund reported operating income of \$1,085, which represents an increase of \$49 or 5%. This is primarily a result of increased loan interest and administrative fees, which are monies received as part of loan repayments. Borrowers are required to pay interest and administrative fees on funds disbursed during construction as well as throughout the life of the loan, consequently, as the amount of loans outstanding increases for the Fund, income from interest and administrative fees will also increase. The Fund reported an overall increase of \$10,056 in total net assets for the fiscal year ended June 30, 2005.

Federal grant revenue decreased by \$6,803 or 50%, and the State match decreased by \$1,360, as a result of the decrease amount of loan disbursements made in fiscal year 2005.

Total operating expenses increased \$120 or 23%, mostly as a result of increased personnel costs and contractual service costs.

Requests for Information

This financial report is designed to provide a general overview of the Fund's finances to the users of such data. Requests for additional copies of this report, questions concerning any of the information in this report, and requests for additional financial information should be addressed to:

Alan J. Farling, P.E., Program Administrator  
State of Delaware  
Department of Natural Resources & Environmental Control  
Division of Water Resources  
5 E. Reed Street, Suite 200  
Dover, DE 19901

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
STATEMENTS OF FUND NET ASSETS  
JUNE 30, 2005 AND 2004

	2005				2004 (Restated)			
	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total
<b>ASSETS</b>								
<b>CURRENT ASSETS</b>								
Cash	\$ 7,991	\$ 34,422,908	\$ 5,061,459	\$ 39,492,358	\$ 8,496	\$ 30,231,081	\$ 4,505,581	\$ 34,745,158
Grants receivable	-	38,903	-	38,903	-	34,132	-	34,132
Administrative fees receivable	-	-	837,086	837,086	-	-	651,486	651,486
Interest receivable	-	103,191	-	103,191	-	106,754	-	106,754
Loans receivable - current	-	3,396,417	-	3,396,417	-	3,387,965	-	3,387,965
	7,991	37,961,419	5,898,545	43,867,955	8,496	33,759,932	5,157,067	38,925,495
<b>NONCURRENT ASSETS</b>								
Loans receivable - less current portion	-	77,617,053	-	77,617,053	-	72,452,697	-	72,452,697
<b>TOTAL ASSETS</b>	<b>\$ 7,991</b>	<b>\$ 115,578,472</b>	<b>\$ 5,898,545</b>	<b>\$ 121,485,008</b>	<b>\$ 8,496</b>	<b>\$ 106,212,629</b>	<b>\$ 5,157,067</b>	<b>\$ 111,378,192</b>
<b>LIABILITIES AND NET ASSETS</b>								
<b>CURRENT LIABILITIES</b>								
Vouchers payable	\$ -	\$ 38,903	\$ 47,686	\$ 86,589	\$ -	\$ 34,157	\$ 2,473	\$ 36,630
<b>TOTAL LIABILITIES</b>	<b>\$ -</b>	<b>\$ 38,903</b>	<b>\$ 47,686</b>	<b>\$ 86,589</b>	<b>\$ -</b>	<b>\$ 34,157</b>	<b>\$ 2,473</b>	<b>\$ 36,630</b>
<b>NET ASSETS - unrestricted</b>	<b>7,991</b>	<b>115,539,569</b>	<b>5,850,859</b>	<b>121,398,419</b>	<b>8,496</b>	<b>106,178,472</b>	<b>5,154,594</b>	<b>111,341,562</b>
<b>TOTAL LIABILITIES &amp; NET ASSETS</b>	<b>\$ 7,991</b>	<b>\$ 115,578,472</b>	<b>\$ 5,898,545</b>	<b>\$ 121,485,008</b>	<b>\$ 8,496</b>	<b>\$ 106,212,629</b>	<b>\$ 5,157,067</b>	<b>\$ 111,378,192</b>

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS  
YEARS ENDED JUNE 30, 2005 AND 2004

	2005				2004 (Restated)			
	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total
OPERATING REVENUES								
Interest Income on loans	-	\$ 649,201	\$ -	\$ 649,201	-	\$ 572,865	\$ -	\$ 572,865
Administrative fee revenue	-	-	1,072,082	1,072,082	-	-	977,391	977,391
Application Fees	-	-	3,183	3,183	-	-	2,814	2,814
Other Income	-	1,226	-	1,226	-	2,599	-	2,599
	-	650,427	1,075,265	1,725,692	-	575,464	980,205	1,555,669
OPERATING EXPENSES								
Reimbursable Expenditures Under								
Personnel costs	123,560	-	339,429	462,989	207,278	-	209,868	417,146
Travel	-	-	2,893	2,893	-	-	2,575	2,575
Contractual Services	51,851	-	109,436	161,287	-	14,950	40,971	55,921
Supplies and Office Expenses	-	-	11,107	11,107	-	1,532	19,740	21,272
Other Expenses	-	1,115	1,515	2,630	-	-	22,880	22,880
Loans made	-	8,862,553	-	8,862,553	-	17,029,913	-	17,029,913
	175,411	8,863,668	464,380	9,503,459	207,278	17,046,395	296,034	17,549,707
Adjustments to Reconcile								
Reimbursable Expenditures	-	(8,862,553)	-	(8,862,553)	-	(17,029,913)	-	(17,029,913)
to Operating Expenses	-	(8,862,553)	-	(8,862,553)	-	(17,029,913)	-	(17,029,913)
Leas: Loans made	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-
TOTAL OPERATING EXPENSES	175,411	1,115	464,380	640,906	207,278	16,482	296,034	519,794
OPERATING INCOME (LOSS)	(175,411)	649,312	610,885	1,084,786	(207,278)	558,982	684,171	1,035,875
NONOPERATING REVENUE								
Interest income on deposits	-	600,929	85,380	686,309	-	381,634	56,330	437,964
Contributions - EPA	147,038	6,757,346	-	6,904,384	180,859	13,525,494	-	13,706,353
Contributions - State	27,868	1,353,510	-	1,381,378	34,282	2,706,999	-	2,741,281
	174,906	8,711,785	85,380	8,972,071	215,141	16,614,127	56,330	16,885,598
CHANGE IN NET ASSETS - unrestricted	(505)	9,361,097	696,265	10,056,857	7,863	17,173,109	740,501	17,921,473
BEGINNING NET ASSETS (Note 7)	8,496	106,178,472	5,154,594	111,341,562	633	89,005,363	4,414,093	93,420,089
ENDING NET ASSETS - unrestricted	7,991	\$ 115,539,569	\$ 5,850,859	\$ 121,398,419	\$ 8,496	\$ 106,178,472	\$ 5,154,594	\$ 111,341,562

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
STATEMENTS OF CASH FLOWS  
YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004 (Restated)
<b>Cash flows from operating activities</b>		
Loan collections	\$ 3,704,732	\$ 3,607,345
Interest received from borrowers	652,764	566,137
Administrative fee revenue	902,299	802,772
Application fees and other revenue	3,952	6,182
Loan disbursements	(8,862,888)	(17,029,913)
General expenses paid	(620,959)	(537,294)
	<hr/>	<hr/>
Net cash provided (used) by operating activities	(4,220,100)	(12,584,771)
<b>Cash flows from noncapital financing activities</b>		
Grants received from EPA	6,900,420	14,382,050
Grants received from State of Delaware	1,380,571	2,876,086
	<hr/>	<hr/>
Net cash provided by noncapital financing activities	8,280,991	17,258,136
<b>Cash flows from investing activities</b>		
Interest on deposits	686,309	437,964
	<hr/>	<hr/>
Net cash provided by investing activities	686,309	437,964
	<hr/>	<hr/>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	4,747,200	5,111,329
Cash and cash equivalents, beginning of year	34,745,158	29,633,829
	<hr/>	<hr/>
Cash and cash equivalents, end of year	<u>\$ 39,492,358</u>	<u>\$ 34,745,158</u>
<b>Cash flows from operating activities</b>		
Operating income	\$ 1,084,786	\$ 837,520
Adjustments to reconcile operating income to net cash provided by operating activities:		
Administrative fees receivable	10,627	11,767
Interest receivable	(192,664)	5,241
Other receivables	-	743
Loans receivable	(5,172,808)	(12,622,747)
Vouchers payable	49,959	(797,348)
Accrued expenses	-	(19,947)
	<hr/>	<hr/>
Net cash used by operating activities	<u>\$ (4,220,100)</u>	<u>\$ (12,584,771)</u>

The accompanying notes are an integral part of these statements.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005

**NOTE 1     SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

This summary of significant accounting policies of the Delaware Water Pollution Control Revolving Loan Fund ("Fund" or "SRF") is presented to assist in understanding the Fund's financial statements. The financial statements and notes are representations of the Fund's management which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

**General Background**

The Fund was created by the 1990 session of the Delaware General Assembly and received its first state appropriation on July 1, 1990. The Fund's purpose is to make below-market interest rate loans to local governments, individuals, and other qualifying applicants under the Environmental Protection Agency's ("EPA") Capitalization Grants for State Revolving Funds federal assistance program. The Fund's enabling legislation empowers the Department of Natural Resources and Environmental Control ("DNREC") to administer the Fund.

**Basis of Accounting**

The Fund accounts for its operations as a proprietary enterprise fund under governmental accounting standards. Accordingly, the economic resource measurement focus and the accrual basis of accounting is followed and commercial accounting principles are applied. The accrual basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable, and expenses in the accounting period in which they are incurred and become measurable without regard to the receipt or payment of cash.

**STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
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NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005**

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)**

**Basis of Accounting (cont'd.)**

The Fund is a special purpose government proprietary fund engaged only in business-type activities. In accordance with the provisions of Governmental Accounting Standards Board Statement No. 34, the Fund needs only to present the financial statements required for proprietary funds, the required supplemental information and Management's Discussion and Analysis.

**Type of Entity and Division of Funds**

The Fund's activities are accounted for as a distinct operating unit and a Proprietary Fund within DNREC's Division of Water Resources. Accordingly, the financial statements of the Fund are intended to present the financial position, results of operations and cash flows of proprietary fund types of only that portion of the funds of the State of Delaware that are attributable to the transactions of the Fund.

The Fund is divided into three sub-funds:

- The Federal Administrative Fund, which accounts for program-related administrative activities;
- The Capital Reserve Loan Fund, which accounts for capital lending and repayment activities; and
- The Non Federal Administrative Fund, which accounts for monies which the State of Delaware ("State") has been authorized, by the EPA, to allocate from the SRF program and use at its own discretion, without federal oversight.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)**

**Adoption of GASB Statement 20**

The Fund has adopted the provision of GASB Statement 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", which provides for the consistent application or nonapplication to proprietary and nonexpendable trust funds of pronouncements of the Financial Accounting Standards Board ("FASB"), issued after November 30, 1989. Accordingly, the Fund has elected not to adopt FASB pronouncements issued after November 30, 1989, unless GASB specifically adopts such pronouncements.

**Recognition of Revenues**

Federal assistance provided by the Capitalization Grants for the SRF program is earned when qualified expenditures are incurred by the borrowers and the Fund. Matching funds provided by the State are considered earned by the same criteria. Amounts earned in excess of grant monies received from the EPA and the State are recorded as grants receivable, whereas a deficiency of such amounts is considered deferred grant revenue.

To permit comparability to grant revenues earned and fiscal budgets, expenditures reimbursable under the Fund's program guidelines are listed separately by object category and subtotaled in the statement of revenues, expenses and changes in net assets.

Operating revenues include those that result from the Fund's lending activities. Non-operating revenues include those from non-capital financing and investing activities.

**STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005**

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)**

**Cash Equivalents**

Cash and cash equivalents consist of demand deposits, short-term money market funds and other deposits held by financial institutions, generally with a maturity of three months or less when purchased. Cash and cash equivalents are reported as deposits.

Cash and cash equivalents as reported on the statement of net assets are held by the State Treasurer Office. All cash deposited with the State Treasurer by State agencies is maintained by the Treasurer in various pooled investment funds. The State Treasurer invests the deposited cash including the cash float in short-term securities and other investments.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 2    CASH**

*Cash:* "Cash" as reported on the statement of net assets represents the Fund's allocated share of cash, cash equivalents and investments under the control of the Treasurer of the State of Delaware ("Treasurer"). All cash is deposited with the Treasurer by state agencies and maintained by the Treasurer in various pooled funds. The Treasurer invests the deposited cash including cash float in short-term securities and other investments. However, the Fund may deposit or withdraw cash at any time without prior notice or penalty. Interest income is credited to the Fund based on the weighted average rate of return on the State's monies applied to the Fund's average daily cash balance. The classification of pooled cash of the Fund is not determinable at the entity level. Pooled investments represent those investments in units of a pool rather than specific securities. As a result, such investments are not categorized as to risk because they are not evidenced by securities that exist in a physical or book-entry form.

*The Cash Management Policy Board:* The State of Delaware's ("State") policy for the investment of State Funds is the responsibility of the Cash Management Policy Board (the "Board"). The Board, created by State law, establishes policies for and the terms, conditions, and other matters relating to the investment of all money belonging to the State except money in any State pension fund and money held under the State deferred compensation program.

*Investment Guidelines and Management:* The investment guidelines adopted by the Board provide, among other things, that no more than 10% of the portfolio may be invested in obligations of any one issuer other than the U.S. Government. Investments may be made only in fixed income instruments with maturities of up to five years in certain circumstances.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
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NOTES TO THE FINANCIAL STATEMENTS  
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**CASH (Cont'd.)**

*Collateralization Requirements:* All State funds are required by law to be collateralized by direct obligations of, or obligations which are guaranteed by the United States of America, or other suitable obligations as determined by the Board, unless the Board shall find such collateralization not in the best interest of the State. The Board has determined that certificates of deposit and time deposits must be collateralized unless the bank issuing the certificate has assets of not less than \$5 billion and is rated not lower than "B" by Fitch, Inc.'s Bank Watch Service. The Board has also determined that State's demand deposits need not be collateralized provided that any bank that holds these funds has for the last two years, a return on average assets of 5% or greater and an average equity - capital ratio of at least 1:20.

If the bank does not meet the above criteria, collateral must consist of one or more of the following:

- (a) U.S. Government securities;
- (b) U.S. Government agency securities;
- (c) Federal Home Loan Board letters of credit;
- (d) State of Delaware securities; or
- (e) Securities of a political subdivision of the State with a Moody's Investors Service rating of "A" or better.

Additionally, the bank must ensure that those securities pledged as collateral have a market value equal to or greater than 102% of the ledger balance(s) in the account(s) each day and ensure that securities pledged are identified as held in the State's name and are segregated on the bank's records.

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**CASH (Cont'd.)**

The cash account in the Federal Administrative Fund represents grant funds drawn to pay administrative expenses of the fund. The grant agreement permits an amount up to 4% of grant revenues over the life of the program for these administrative expenses.

The cash account in the Capital Reserve Loan Fund represents all principal and interest received from Fund loans. These dollars are earmarked for future loans in accordance with applicable federal regulations.

Cash from administrative fees on municipal loans is recorded in the Non-Federal Administrative Fund, and is then available to the State for use at its discretion.

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REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
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**NOTE 3    LOANS RECEIVABLE**

The loans receivable account is made up of the following major categories:

	<u>2005</u>	<u>2004</u>
<b>Municipal</b>		
• Sussex County Council	\$48,604,031	\$44,630,877
• City of Wilmington	12,683,284	13,608,263
• City of Seaford	5,902,808	6,243,433
• Kent County	3,498,029	3,688,391
• City of Milford	1,505,043	1,572,047
• Town of Selbyville	1,599,579	1,200,040
• Town of Laurel	848,587	729,073
• City of Dover	609,336	639,511
• Camden Wyoming Sewer & Water Authority	317,314	324,336
• Town of Milton	460,733	284,031
• Town of Millsboro	101,911	-
• Town of Bridgeville	1,245,639	-
• City of Lewes	452,185	-
• Rehoboth Bay Conservancy	305,940	-
 Septic Rehabilitation Program	 1,358,940	 1,390,265
 Agriculture Non-Point Source Loan Program	 1,141,915	 1,170,524
 Dairy Loan Program	 222,613	 191,595
 Underground Storage Tank Program	 <u>155,583</u>	 <u>168,276</u>
 Total	 <u>\$81,013,470</u>	 <u>\$75,840,662</u>
  Current portion	  \$ 3,396,417	  \$ 3,387,965
Long-term portion	<u>77,617,053</u>	<u>72,452,697</u>
 Total	 <u>\$81,013,470</u>	 <u>\$75,840,662</u>

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005

**LOANS RECEIVABLE (Cont'd.)**

Interest charged on these loans ranges from 1.5% to 6.0% for both 2005 and 2004. Loan maturities vary, based on individual agreements. General Obligation and Municipal Revenue bonds are collateral for municipal loans; business assets and real estate are collateral for other loans.

There is no allowance for doubtful loans at June 30, 2005 and 2004 as all loans are secured and will eventually be collected. There were no material delinquent loan balances and no loan defaults for 2005 and 2004.

**NOTE 4      SIGNIFICANT SOURCE OF REVENUE - STATE REVOLVING  
FUND GRANT**

The Fund currently derives a significant portion of its revenue from EPA State Revolving Fund Capitalization Grant awards and mandatory state matching funds. The total funds awarded through a series of agreements during the federal capitalization period (October 1, 1990 through June 30, 2005) were \$128,627,016 which includes the federal portion of \$107,189,180, or five-sixths, and the state matching portion of \$21,437,836, or one-sixth.

According to Federal program guidelines, the Fund may spend up to four percent (4%) of the federal awards on administrative expenses. As previously described in Note 1, a separate Administrative Fund is used to account for such costs and related revenues.

The table below summarizes funding for the Fund over the capitalization period:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
Awards made through June 30, 2005	<u>\$ 107,189,180</u>	<u>\$ 21,437,836</u>	<u>\$ 128,627,016</u>
Awards expended through June 30, 2005	<u>\$ 91,083,739</u>	<u>\$ 18,212,032</u>	<u>\$ 109,295,771</u>

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005

**NOTE 5    PENSION PLAN**

Employees of the Fund are considered employees of the State of Delaware ("State") and are covered under The State Employees' Pension Plan. Total pension cost of \$44,535 for 2005 and \$37,322 for 2004 is included in the financial statements as personnel costs. Certain significant plan provisions follow:

Detailed information regarding this plan is available in the Delaware Code and the Rules and Regulations of the Board of Pension Trustees.

Plan Description and Eligibility: The State Employees' Pension Plan is a cost-sharing multiple employer defined benefit plan that covers virtually all full-time or regular part-time employees of the State, including employees of other affiliated entities.

Service Benefits: Final average monthly compensation multiplied by 2.0% and multiplied by years of credited service prior to January 1, 1997 plus final average compensation multiplied by 1.85% and multiplied by years of credited service after December 31, 1996, subject to minimum limitations. For this plan, final average monthly compensation is the monthly average of the highest three years of compensation.

Vesting: Five (5) years of credited service.

Retirement: Age 62 with five (5) years of credited service; age 60 with 15 years of credited service; or after 30 years of credited service at any age.

Disability Benefits: Same as Service Benefits. Employee must have five (5) years of credited service.

Survivor Benefits: If employee is receiving a pension or is active with at least five (5) years of credited service, eligible survivor receives 50% (or 75% with 3% reduction of benefit) of the benefit the employee would have received at age 62.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
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NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005

**PENSION PLAN (Cont'd.)**

Contributions:

- Employer – Determined by Board of Pension Trustees.
- Employee - 3 % of earnings in excess of \$6,000.

Death Benefit: \$7,000 per member.

The Delaware Public Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information of the plan. The financial report may be obtained by writing to the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite #1, 860 Silver Lake Boulevard, Dover, Delaware 19904-2402.

**NOTE 6 COMMITMENTS AND CONTINGENCIES**

**Operating Lease**

Beginning July 1, 1997, DNREC entered into a lease for office space, on behalf of the Fund, of which the Fund pays 75%. The three-year operating lease was effective from July 1, 1997 through June 30, 2000, but has been extended since then. Most recently, the lease was renewed for a one-year term expiring January 31, 2006.

Future minimum rental payments are as follows:

<u>Fiscal Year Ending</u>	<u>Amount</u>
2006	\$ 17,407

Rent expense, which is included in the financial statements as contractual services, was \$29,402 in 2005 and \$30,893 in 2004.

**STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005**

**COMMITMENTS AND CONTINGENCIES (Cont'd.)**

**Loans**

Binding loan commitments as of June 30, 2005 are \$8,442,346.

**Cost Reimbursement Contracts**

The Fund derives all of its non-operating revenue from EPA Capitalization Grants for State Revolving Fund program and mandatory state matching funds which are contracts based on the reimbursement of allowable costs related to the program. Costs are subject to review by the EPA. Any adjustments arising from disallowed costs are recorded in the Fund's financial statements.

**NOTE 7 PRIOR PERIOD ADJUSTMENT AND RESTATEMENT**

Certain municipal loan agreements do not require payment of interest until a specific period, however, the interest accrues at a given rate during that period. Prior to 2005, this interest income was not recorded in the year in which it was earned.

As a result, the 2004 financial statements have been restated to reflect additional interest income earned during 2004 of \$198,355, beginning retained earnings for 2004 has been increased by \$384,382 to record the interest income earned prior to 2004 but not recorded, and interest receivable as of June 30, 2004 has been increased by \$582,737.

**STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2005**

**NOTE 8     RISK MANAGEMENT**

The Fund falls under the State of Delaware's insurance plans. The State is exposed to various risks of losses related to workers' compensation, employee health-care and accident, automobile accident, police professional malpractice and property and casualty claims. It is the policy of the State not to purchase commercial insurance to cover these risks. Instead, State management believes it is more economical to manage its risk internally and thus, covers all claim settlements and judgments out of its General Fund. The State continues to carry commercial insurance for all other risks of loss, including general liability and the remainder of the property and casualty liability. There have been no significant reductions in insurance coverage from prior years. In the past three years of insured coverage, settled claims have not exceeded commercial coverage.

Claim liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred by not reported. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process does not result in an exact amount. Claim liabilities are re-evaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

At June 30, 2005, there were no outstanding or pending claims against the Fund.

Independent Auditors' Report on Internal Control Over  
Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed  
in Accordance with Government Auditing Standards

To the Management  
Delaware Water Pollution Control  
Revolving Loan Fund  
State of Delaware

We have audited the financial statements of the Delaware Water Pollution Control Revolving Loan Fund (the Fund) of the State of Delaware, as of and for the year ended June 30, 2005 and have issued our report thereon dated September 14, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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Independent Auditors' Report on Internal Control Over  
Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed  
in Accordance with Government Auditing Standards (Cont'd.)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended for the information of the Fund's management, the Governor, the Attorney General, the Controller General, the Office of Management and Budget, the Secretary of Finance, the Office of Auditor of Accounts and the Environmental Protection Agency, and is not intended to be used and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited.

*McBride, Shopa & Co*

Wilmington, Delaware  
September 14, 2005

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
SCHEDULE OF REPORTABLE CONDITIONS AND QUESTIONED COSTS  
FISCAL YEAR ENDED JUNE 30, 2005

**CURRENT YEAR CONDITIONS**

NONE

**STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
SCHEDULE OF REPORTABLE CONDITIONS AND QUESTIONED COSTS  
FISCAL YEAR ENDED JUNE 30, 2005**

**SCHEDULE OF PRIOR YEAR CONDITIONS**

**CONDITION 04 -01:**

The Financial Assistance Branch performs cash reconciliations for their multiple cash accounts every month. These reconciliations adjust for certain timing differences that usually reverse themselves during the next month.

We noted that the ending cash balance per the general ledger for one cash account at June 2004 did not agree to the DFMS balance at June 2004 by approximately \$1 million. We noted that the cause of this discrepancy was a reconciliation error dating back to November 2003. The ending cash balance in October 2003 (per reconciliation) was \$1 million dollars more than the beginning cash balance stated in November's reconciliation.

**RECOMMENDATION:**

The cash reconciliation process currently analyzes the monthly activity adjustment between DFMS and Peachtree. The Financial Assistance Branch must ensure the following steps are also performed every month:

1. Ensure the ending balance from prior month agrees with the beginning balance of current month.
2. Cumulative differences between DFMS and Peachtree should be reviewed for reasonableness. This will help find any bookkeeping errors as well as ensure that timing differences that should reverse after one month do so.

**AUDITEE'S PLAN FOR CORRECTIVE ACTION:**

A safeguard was added to the existing monthly reconciliation worksheets that will make future bookkeeping errors more evident. With the addition of additional balance and variance check fields, the reconciliation worksheet now displays variances that would warrant investigation. Ending balances and beginning balances are now compared and overall balance variances are also displayed by the reconciliation. A misposted transaction will now be easily identifiable and adjusted in a timely manner.

STATE OF DELAWARE  
DELAWARE WATER POLLUTION CONTROL  
REVOLVING LOAN FUND  
SCHEDULE OF REPORTABLE CONDITIONS AND QUESTIONED COSTS  
FISCAL YEAR ENDED JUNE 30, 2005

**SCHEDULE OF PRIOR YEAR CONDITIONS (Cont'd.)**

**CURRENT STATUS:**

The monthly reconciliations are now being reviewed for errors and differences. All variances are researched and explained.